

KENTUCKY

TEACHERS' RETIREMENT SYSTEM

RETIRED MEMBER
EDITION



December
2009

Retirement Security in Uncertain Times

A Message from the Executive Secretary
Gary L. Harbin, CPA

Since 1940, KTRS has provided retirement security for the teachers of Kentucky whether the financial markets were tranquil or volatile, on the rise or falling. Although there has been considerable turmoil in the global financial system, KTRS's investment program has weathered the economic storm remarkably well.

For the year ended June 30, 2009, KTRS's investment performance ranked in the top 7% compared to 55 other state-wide pension plans in the nation and in the top 22% over the past three years. (Source: Pension Fund Data Exchange). KTRS's superior investment performance during this period of turmoil reflects the KTRS Board's steadfast and continuing focus on the retirement security of

the teachers of Kentucky. The following are steps KTRS is currently taking to ensure ongoing retirement security.

Long-term Investment Strategy

Focusing on retirement security begins with a disciplined process of investing. KTRS adheres to a carefully planned long-term investment strategy rather than making short-term decisions based upon an emotional response to market conditions. Careful long-term planning and risk control helped KTRS avoid unsound investments, which have resulted in devastating losses for many investors during the economic downturn.

KTRS's investment strategy is uniquely tailored to fit the

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The Value of Your KTRS Defined Benefit Group Retirement Plan

KTRS is a **Defined Benefit Group Retirement Plan** and offers true retirement security in an efficient manner for both the retiree and the Commonwealth. Unlike Defined Contribution Individual Savings Accounts such as 401(k) accounts, "DB" Group Retirement Plans are guaranteed to provide a retirement allowance for the life of the individual retiree. Persons who are wholly dependent upon a 401(k) account do not know how much to save for retirement as no one knows how long he or she is going to live and thus there is the risk of running out of retirement savings with years of life ahead. However, DB Group Retirement Plans, which operate similarly to insurance policies by pooling "longevity risk", know exactly what the average life expectancy of the members are and therefore know the amount of funds that need to be collectively set aside for their participants' retirements...no more, nor no less. Studies have also shown that on average, DB Group Retirement Plans can negotiate lower investment fees and enjoy higher investment returns than

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particular liability requirements of the Retirement System. Developing the strategy is a complex process that often takes more than a year to complete. Although the process is time consuming, strategy is the most important determinant of the program's success. The process of reviewing KTRS's long-term strategy is undertaken at least every five years.

The first step in developing an investment strategy is identifying the liabilities of the Retirement System. KTRS's independent actuary performs a detailed study to forecast variables in the KTRS plan such as the number of members, the number of retirees, the amount of retiree benefit payments, the funded status of pension and health benefits, and unfunded accrued liability. All of these projections are based upon KTRS's unique demographics and become the foundation for developing an investment strategy.

Upon completion of the liability study, KTRS's independent investment consultant begins the work of identifying an optimal asset allocation based upon the plan's liabilities. In short, the investment consultant constructs a customized plan to identify which asset classes to use and in what percentage in the overall portfolio. The asset allocation study includes numerous considerations such as identifying an adequately diverse mix of assets, a prudent level of risk, cash flow requirements, funding challenges, and other unique characteristics of KTRS. The resulting asset allocation recommendations are incorporated into KTRS's investment strategy to match the liabilities identified by the actuary in the liability study.

KTRS is now completing the review of its long-term investment strategy and will begin implementing changes in early 2010. Under the updated strategy, KTRS expects to continue diversifying the investment portfolio and expanding its global and opportunistic investments.

Operational and Governance Review

On September 21, 2009, the KTRS Board received a final report concerning the operational and governance structure of the KTRS investment

program. The report was conducted by Ennis Knupp, an independent investment consulting firm, and represented more than 10 months of detailed work.

In commissioning the operational and governance review, the KTRS Board is again on the leading edge of best governance practices for the public pension community. Undertaking an operational and governance review of investment programs is a developing trend. The Board should be commended for its foresight in commissioning the report.

The report confirms that KTRS has a sound and cost effective investment program. In almost all functional areas of the investment program, KTRS currently utilizes "best practices" or "prevalent practices." In terms of governance structure, trustee education, and cost effectiveness, the report confirms that KTRS is a "cutting edge" leader in the public pension community. The report highlighted the Board's action to broaden investment expertise available to the System, including adding two nationally recognized investment experts, Mr. Bevis Longstreth and Mr. George Philip, to the KTRS Investment Committee.

However, even a sound and cost effective investment program can improve and we look forward to evaluating and continuing to implement the recommendations in the report. The most significant finding in the report is that KTRS is required by statute to have its investment policies set forth in administrative regulations. This requirement unduly restricts KTRS and is not considered best practices. The KTRS Board will be addressing this matter with the General Assembly.

The other significant finding in the report relates to funding retiree health insurance benefits. Ennis Knupp writes: "...The investment activity, no matter how it is pursued, cannot make up for the loss in contributions that have been diverted from the pension fund into the medical fund...." The Board has been working on this issue for many years. Looking forward to the 2010 legislative session, KTRS is continuing to communicate with affected groups to help facilitate a long-term solution of pre-funding retired teachers' health care. Developing a long-term solution of pre-funding retired teachers' health care will help ensure ongoing retirement security.

KTRS's Administrative Expenses are Carefully Controlled

Lately the news media have been full of stories about inappropriate spending at certain organizations. Audits conducted by the Auditor of Public Accounts have confirmed abuses at some of these organizations.

The philosophy and practice of KTRS's business operations is fundamentally different from those organizations appearing in the news. By law, KTRS may only use its members' retirement funds for the *"...exclusive purpose of providing benefits... and defraying reasonable expenses of administering the system...."* (Emphasis added.) To ensure compliance with this and other standards, KTRS's nine member Board has mandated adherence to strict accounting standards and a system of internal controls. Moreover, the Board has established a Governance and Audit Committee to assist the Board in fulfilling its fiduciary oversight responsibilities for all administrative expenses of the system.

The Governance and Audit Committee meets at least twice each year and may review issues concerning plan governance, financial reporting, risk management, internal control, internal and external audit, and monitoring compliance with laws and regulations. The Governance and Audit Committee is staffed by an independent internal auditor, who provides audit reports to the Committee and develops the annual audit plan in consultation with the Committee. The external auditor also reports to the Committee.

On August 28, 2009, the Governance and Audit Committee performed an in-depth review of travel expenses and other administrative expenses. The KTRS Board uses the Commonwealth's travel policy as the standard for reimbursement of reasonable, business travel expenses. In this regard, employees or trustees traveling on KTRS business must have their proposed trip and estimated expenses approved in advance. After returning from travel, the employee or trustee may seek reimbursement for mileage, airfare, lodging, and meals that conform to the Commonwealth's travel policy. The August 28th in-depth review confirmed that KTRS's

travel expenses are appropriate and conform to the Commonwealth's travel policy. Also, the Committee confirmed that KTRS internal controls for payment of administrative expenses are adequate.

In December 2009, the Governance and Audit Committee will meet to consider the annual audit performed by KTRS's independent external auditor. The external audit is a comprehensive review of KTRS's operations and compliance with applicable accounting standards and laws. Following completion of the audit, the final report will be posted on KTRS's website and filed with the Auditor of Public Accounts and other government agencies.

The Board of Trustees and staff of KTRS are fiduciaries of the retirement funds of members and beneficiaries of the Retirement System. Everyone at KTRS is committed to making sure that your retirement dollars are used to pay only reasonable and appropriate expenses.

Questions?



**Call the KTRS
Information Center**

1-800-618-1687

DEFINED BENEFIT continued from page 1 ...

individuals do with their 401(k) accounts. As a long-term, group investor, rather than an individual, short-term investor, DB Group Retirement Plans can afford to invest in a more diversified portfolio and have a greater capacity for riding out periodic downturns in the market. All of these reasons make the DB Group Retirement Plan a better bet for Kentucky's educators, most of whom do not participate in the federal Social Security program and therefore rely primarily upon KTRS for their retirement security.

Medicare Eligible Health Plan and Federal Health Care Reform Updates

Where we have been, what we have saved, and the next logical steps.

Generally-Federal Reform Initiatives and the Opportunity for Savings

As you already know, KTRS took advantage of two options under the Medicare Modernization Act of 2003 that enabled cost containment within the medical and prescription drug programs. Many entities like KTRS chose to keep their drug plans primary, and sought the available subsidies offered by Medicare Part D. Also, many entities like KTRS moved to a Medicare Advantage Private Fee For Service Plan, as the Medicare medical subsidies were deeper than those with traditional Medicare Parts A and B.

As indicated in previous newsletters, these savings initiatives were not guaranteed to last indefinitely. However, the KTRS Board of Trustees viewed, and still views, as part of its fiduciary responsibility the obligation to contain costs where practical without shifting costs to members or decreasing members' benefits, even if the savings measure was only available for a few years. The recent changes to Medicare have been the greatest seen in 40 years, and the savings afforded by these changes were substantial enough to provide a positive impact on the KTRS Medical Insurance Fund. Since 2006, the combined savings from these federal initiatives totaled approximately \$60 million.

KTRS, through its non-partisan involvement with groups such as the Public Sector Healthcare Roundtable, will continue to monitor any future federal initiatives or federal health care reform that will produce savings and help to maintain valuable medical and drug benefits for Kentucky retired educators. When and if there is a final piece of 2009 health care reform legislation, then KTRS will need to study any positive or negative effects on the KTRS health plan. KTRS and the Public Sector Healthcare Roundtable support national health care reform because of the increased health care costs of "doing nothing", but we want to ensure that the KTRS health plan is not harmed by any final health care reform bill. With the always possible

unintended consequences, we will need to be careful and cautious. All parties support cleaning up any fraud, waste, and abuse within the Medicare program, but we need to make sure that the predicted dollar savings from cleaning this up is realistic. We do not want to see Medicare benefit cuts to offset the cost of insuring the uninsured. Also, KTRS is watching any federal or state excise taxes placed on health benefits above a certain threshold, as this will have cost implications for the KTRS Medical Insurance Fund and for KTRS retirees.

Specifically, the KTRS Drug Plan

KTRS's 2009 self-funded Medicare Eligible Prescription Drug Plan pays prescription claims as the primary payer. The Medicare Modernization Act legislation opened a window of opportunity for insurance carriers or pharmaceutical benefits managers to offer insured drug plans called Employer Group Waiver Prescription Drug Plans. These plans have been well received in the group market producing a competitive environment. As previously reported, KTRS issued a Request for Qualifications (RFQ) for a broker/consultant for a Medicare Prescription Drug Plan, known as an Employer Group Waiver Plan under the Medicare Modernization Act, and AON Consulting was the successful respondent to this RFQ in March 2009.

In the summer of 2009, AON Consulting drafted a solicitation in accordance with the existing Medicare Eligible Prescription Drug Plan design, so that plan design, out-of-pocket costs, and pharmacy access would not materially change. The solicitation further explored this opportunity and determined that an additional annual savings of approximately \$5 million can be achieved with minimal benefit disruption to our membership. There will also be a significant reduction in the actuarial accrued unfunded liability for the KTRS Medical Insurance Fund. Hence, this has become the next logical progression for the KTRS Medicare Eligible Prescription Drug Plan.

The current KTRS pharmaceutical benefits manager, Medco, was the successful respondent to this bid in the fall of 2009 for an effective date of July 01, 2010. On July 01, 2010 KTRS will have a Medco insured Employer Group Waiver Prescription Drug Plan instead of the current KTRS self-funded Medicare Eligible Prescription Drug Plan. New ID cards will be issued prior to July 01, 2010. Again, every attempt will be made by KTRS to mirror the existing KTRS drug plan regarding plan design, out-of-pocket costs, and pharmacy access. There will be a minimal amount of preferred and non-preferred formulary differences and tier-to-tier cost differences, but the current plan already experiences quarterly formulary changes based upon findings of Medco's Pharmacy and Therapeutics Committee. Further details will be communicated in early 2010.

KTRS has received \$41.8 million in Medicare Part D subsidies from January 2006 through June 2009. These funds have been credited to the KTRS Medical Insurance Fund. The expected and additional \$5 million in annual savings will also be credited to the KTRS Medical Insurance Fund.

Specifically, the KTRS Medical Plan

As you already know, the Medicare Modernization legislation opened another window of opportunity for the offering of a group insurance plan called the Group Medicare Advantage Private Fee-For-Service (PFFS) Plan. In order to entice insurance carriers to cover under-served Medicare beneficiaries living in rural areas throughout the United States plus promote disease and case management and wellness, Medicare began providing more in subsidies for the Group Medicare Advantage PFFS Plan compared to traditional Medicare Parts A and B. Since January 2007, KTRS has been with a customized Humana insured group plan that mirrored the existing KTRS plan design elements with no material participant out-of-pocket cost changes. Since January 2007, the KTRS Medical Insurance Fund has saved approximately \$20 million with this insured plan.

The American Recovery and Reinvestment Act (ARRA aka Federal Stimulus Package) which passed a year ago, enacted legislation to eliminate the non-network based group PFFS product within the

Medicare Advantage program on December 31, 2010.

As of now, there are still regional PPOs and passive PPOs within the Medicare Advantage program. KTRS is taking the next logical progression by converting to Humana's insured Medicare Advantage Passive PPO effective July 01, 2010. Any disruption to our membership should be minimal because this conversion preserves access to the Medicare Advantage PFFS participating providers and the PPO network is passive; meaning that the KTRS retired Medicare eligible members will not be balance billed when visiting medical providers who are out of Humana's PPO network. KTRS will also continue to see some savings with the Medicare Advantage Passive PPO. In the future, should all Medicare Advantage programs end, KTRS can revert back to a self-funded Medicare supplement or complement style plan with Humana adjudicating the claims; however, this will be more costly to the KTRS Medical Insurance Fund than the Medicare Advantage Passive PPO.

On July 01, 2010 KTRS will have a Humana insured Group Medicare Advantage Passive PPO plan instead of the current Humana insured Group Medicare Advantage PFFS plan. New ID cards will be issued prior to July 01, 2010. Again, every attempt will be made by KTRS to mirror the existing KTRS health plan regarding plan design, out-of-pocket costs, and provider access. Your provider may require some communication and education efforts about Group Medicare Advantage Passive PPO Plans. KTRS and Humana will partner in a strategic communication and education plan with medical providers on this conversion. With early communication and education, any provider concerns will be alleviated quickly. Further details should be communicated in early 2010.

Be Sure to Keep Your Address Current

KTRS retirees and other annuitants are reminded that when they change their address, they should notify KTRS **in writing** in order to continue to receive their KTRS mail on a timely basis. All retirees receive a 1099R in January, a check stub in July indicating COLA increases, and newsletters and special mailings which may include retiree medical insurance information or notices.



All Retirees

Centers for Medicare & Medicaid Services (CMS) Announces Medicare Premiums, Deductibles for 2010

This is an excerpt from a recent Medicare Press Release to be used for informational purposes only. Contact Social Security at 1-800-772-1213 for more information regarding your 2010 Part B premium.

Most Medicare beneficiaries will not see a Part B monthly premium increase as a result of a "hold harmless" provision in the current law. This allows for 73 percent of beneficiaries to be protected from an increase raising the 2010 Part B monthly premiums from \$96.40 to \$110.50. The Administration continues to urge Congressional action that would protect all beneficiaries from higher Part B premiums and eliminate the inequity of a high premium for the remaining 27 percent of beneficiaries.

By law, the Centers for Medicare & Medicaid Services (CMS) is required to announce the Part A deductibles and Part B premium amount - a notice that is published annually in the Federal Register.

Under the Medicare law, the standard premium is set to cover approximately one-fourth of the average cost of Part B services incurred by beneficiaries aged 65 and over. The remaining Part B costs are financed by Federal general revenues. This monthly premium paid by beneficiaries enrolled in Medicare Part B covers a portion of the cost of physicians' services, outpatient hospital services, certain home health services, durable medical equipment, and other items.

In calculating the monthly Part B premium each year, the CMS Office of the Actuary includes a contingency margin to provide for possible variation between actual and projected costs. The size of the contingency margin estimated to be needed for 2010 is affected by two main factors.

First, the current law formula for physician fees, which will result in a reduction in physician fees of approximately 21 percent in 2010 and is projected to cause additional reductions in subsequent years, is

one factor affecting the 2010 contingency margin. For each year from 2003 through 2009, Congress has acted to prevent physician fee reductions from occurring.

In recognition of the strong possibility of increases in Part B expenditures that would result from similar legislation to override the decreases in physician fees in 2010 or later years, it is appropriate to maintain a significantly larger Part B contingency reserve than would otherwise be necessary. The asset level projected for the end of 2009 is not adequate to accommodate this contingency.

Second, the Social Security Administration announced there would be no increase in Social Security benefits for 2010. As a result of the hold-harmless provision, the increase in the Part B premium for 2010 will be paid by only a small percentage of Part B enrollees. Most Part B enrollees will pay the same monthly premium that they paid in 2009 (\$96.40 was the 2009 standard monthly premium).

Approximately 27 percent of beneficiaries are not subject to the hold-harmless provision because they are new enrollees during the year (3 percent), they are subject to the income-related additional premium amount (5 percent), they do not have their Part B premiums withheld from social security benefit payments (19 percent), including those who qualify for both Medicare and Medicaid and have their Part B premiums paid on their behalf by Medicaid (17 percent).

As required in the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), beginning in 2007 the Part B premium a beneficiary pays each month is based on his or her annual income. Specifically, if a beneficiary's "modified adjusted gross income" is greater than the legislated threshold amounts (\$85,000 in 2010 for a beneficiary filing an individual income tax return or married and filing a separate return, and \$170,000 for a beneficiary filing a joint tax return) the beneficiary is responsible for a larger portion of the estimated total cost of Part B benefit coverage. In addition to

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the standard 25 percent premium, such beneficiaries now pay an income-related monthly adjustment amount. These income-related Part B premiums were phased-in over three years, beginning in 2007. About 5 percent of current Part B enrollees are expected to be subject to the higher premium amounts.

Most beneficiaries will continue to pay the same \$96.40 premium amount in 2010. Beneficiaries who currently have the Social Security Administration (SSA) withhold their Part B premium and have incomes of \$85,000 or less (or \$170,000 or less for joint filers) will not have an increase in their Part B premium in 2010. For additional details, see our FAQ titled: "Will my Medicare Part B premium increase in 2010?"

For all others, the standard Medicare Part B monthly premium will be \$110.50 in 2010, which is a 15% increase over the 2009 premium. The Medicare Part B premium is increasing in 2010 due to possible increases in Part B costs. If your income is above \$85,000 (single) or \$170,000 (married couple), then your Medicare Part B premium may be higher than \$110.50 per month. For additional details, see our FAQ titled: "2010 Part B Premium Amounts for Persons with Higher Income Levels".

IMPORTANT: Reminder for Re-employed Retirees



If you are re-employed by an agency that participates in the KEHP and you are eligible for health insurance, you will be required to waive coverage with KTRS. In some instances, *other* employers may offer health insurance that is as good as or better than that offered by KTRS. In those cases, it will be necessary to obtain your insurance coverage through your employer rather than KTRS. Please contact KTRS if you have any questions.

Additionally, once you terminate that active employment or you drop from full-time to part-time employment or, if you become ineligible for employer-provided insurance, **it is your responsibility** to contact KTRS to re-enroll based

on that qualifying event. Loss of insurance coverage with your active employer is a qualifying event that allows you to re-enroll with KTRS even if it is outside of the Open Enrollment period. **You should contact KTRS as soon as you know you will be terminating employment, dropping from full-time to part-time employment, or losing coverage with your active employer for any other reason, but no later than 30-35 days from the qualifying event.** In most cases, you will be required to provide proof of the qualifying event. This information can also be found on our website at www.ktrs.ky.gov.

Retirees Under Age 65

2010 Open Enrollment

The (KTRS) 2010 Open Enrollment closed October 31, 2009. Outside of Open Enrollment, enrollees may add or drop a dependent due to a qualifying event. You must contact KTRS and complete the appropriate forms no later than 30-35 days from the qualifying event. In most cases, you will be required to provide proof of the qualifying event. This information can also be found on our website at www.ktrs.ky.gov.

Reminder: The Kentucky Employees' Health Plan expects to perform a dependent eligibility audit early in 2010. If you are covering a spouse or child, you may be required to provide proof of eligibility at that time.

Retirees Age 65 & Over

Medicare Eligible Health Plan (MEHP) Open Enrollment November 15 – December 31, 2009

This is to inform eligible retirees and spouses, age 65 or older and **not already enrolled** in the KTRS Medicare Eligible Health Plan (MEHP) currently administered by Humana and Medco, that **OPEN**

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MEHP OPEN ENROLLMENT ...

MEHP OPEN ENROLLMENT
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ENROLLMENT began November 15 and ENDS December 31, 2009. If you are currently enrolled in the KTRS MEHP, you do not need to do anything. However, if you are not currently enrolled in the MEHP and wish to have coverage effective January 1, 2010, you may download an MEHP application at www.ktrs.ky.gov or you may contact KTRS at 1-800-618-1687 for an enrollment form and return the completed form to this office by **December 31, 2009**. You must have Part B of Medicare to enroll in the MEHP. During Open Enrollment you can enroll in the MEHP without providing proof of a qualifying event. To enroll outside of Open Enrollment you must show evidence of a qualifying event within 30 days of the event. For the calendar year 2010, the monthly cost for the KTRS MEHP is \$342 per person. Currently, KTRS pays all or a portion of the premium for retirees based on their KTRS entry date and years of service at retirement. Spouses of KTRS retirees pay full premium cost for their coverage.

Please note that upon enrolling in the KTRS MEHP, you must be careful to avoid any pitfall in which your KTRS MEHP would automatically be terminated: (1) enrolling in another Medicare Advantage plan other than the KTRS MEHP. (2) enrolling in a Medicare Part D plan. Medicare rules will not allow you to be enrolled in two Medicare

Advantage Plans and/or two Medicare Part D prescription plans at the same time. (3) your coverage will also be terminated in the event your Medicare Part B lapses or you do not sign up for Medicare Part B in a timely fashion. Medicare charges a penalty for those who do not sign up for Medicare Part B when first eligible. However, if in the future you ever want to cancel your KTRS MEHP, you must submit your request to KTRS in writing. Do not contact Humana, Medco, or Medicare to cancel your KTRS MEHP coverage.

**KTRS Holiday
Closing Schedule for 2009**

The Kentucky Teachers' Retirement System will be closed to observe the upcoming holidays:

Christmas

Thursday & Friday,
December 24 & 25

New Year's

Thursday & Friday,
December 31 &
January 1

KTRS 2010 EFT Payment Dates

January 28
February 25
March 29
April 28
May 27
June 28

July 29
August 27
September 28
October 28
November 24
December 29

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